

# Report of the auditor-general to Eastern Cape Provincial Legislature and the council of Port St Johns Local Municipality

## Report on the audit of the consolidated and separate financial statements

### Qualified opinion

1. I have audited the consolidated and separate financial statements of the Port St Johns Local Municipality set out on pages ... to ..., which comprise the consolidated and separate statement of financial position as at 30 June 2019, the consolidated and separate statement of financial performance, consolidated and separate statement of changes in net assets and cash flow statement and the consolidated and separate statement of comparison of budget and actual amounts for the year then ended, as well as the notes to the consolidated and separate financial statements, including a summary of significant accounting policies.
2. In my opinion, except for the possible effects of the matter described in the basis of qualified opinion section of this auditor's report, the consolidated and separate financial statements present fairly, in all material respects the consolidated and separate financial position of the Port St Johns Municipality as at 30 June 2019, and its consolidated and separate financial performance and cash flows for the year then ended, in accordance with the South African Standards of Generally Recognised Accounting Practice (SA Standards of GRAP) and the requirements of the Municipal Finance Management Act of South Africa, 2003 (Act No.56 of 2003) (MFMA) and the Division of Revenue Act of South Africa, 2018 (Act No.1 of 2018) (Dora).

### Basis for qualified opinion

#### Irregular expenditure

3. I was unable to obtain sufficient and appropriate audit evidence that management had properly accounted for all irregular expenditure. Due to a lack of systems to identify contraventions of the supply chain management (SCM) requirements, it was impracticable to confirm the full extent of irregular expenditure. Consequently, I was unable to determine whether any adjustment to the irregular expenditure as disclosed in note 49 to the consolidated and separate financial statements at R145,3 million (2018: R139,2 million) was necessary.

#### Employee related costs

4. I was unable to obtain sufficient and appropriate audit evidence that management had properly accounted for employee related costs. Due to a lack of systems it was impracticable to confirm the full extent of the misstatement. I was not able to confirm the employee related costs by alternative means. Consequently, I was unable to determine whether any adjustment to the employee related costs in the statement of financial performance and as disclosed in note 28 to the consolidated and separate financial statements at R71,2 million (2018: R71 million) was necessary.

## **Receivables from non-exchange transactions**

5. I was unable to obtain sufficient appropriate audit evidence for receivables from non-exchange transactions due to the status of the accounting records. The municipality did not have adequate systems of internal control for the recording of all transactions and events and could not reconcile these to the financial statements. I could not confirm receivables from non-exchange by alternative means. Consequently, I was unable to determine whether any adjustments were necessary for receivables from non-exchange and contributions to allowances respectively, as disclosed in note 5 & 8 to the consolidated and separate financial statements stated at R33,5 million (2018: R31,5 million) and R28.8 million (2018: R25.6 million) was necessary.

## **Payables from exchange transactions**

6. I was unable to obtain sufficient and appropriate audit evidence that the municipality had properly accounted for leave pay provision included in payables from exchange transactions in the statement of financial position and the notes to the financial statements. Due to a lack of systems it was impracticable to confirm the full extent of the misstatement. Consequently, I was unable to determine whether any adjustment to the payables from exchange transactions in the statement of financial performance and as disclosed in note 13 to the consolidated and separate financial statements stated at R31,4 million (2018: R21,9 million) was necessary.

## **General expenses**

7. The municipality did not have adequate processes in place to ensure that all general expenses in the financial statements was recorded in terms of *GRAP 1, Presentation of financial statements*. Consequently, general expenses in the consolidated and separate statement of financial performance and in note 36 to the consolidated and separate financial statements was overstated by an amount of R3,6 million (2018: R15,5 million). This also has an impact on the vat receivable, surplus for the year and on the accumulated surplus.

## **Property rates**

8. I was unable to obtain sufficient and appropriate audit evidence that the municipality had properly accounted for property rates in the current financial year. The municipality did not have an updated valuation roll for properties. Due to a lack of systems it was impracticable to confirm the full extent of the misstatement. I was not able to confirm the property rates by alternative means. Consequently, I was unable to determine whether any adjustment to the property rates in the consolidated and separate statement of financial performance and as disclosed in note 25 to the consolidated and separate financial statements at R 9,1 million was necessary.
9. The municipality did not have adequate processes in place in the prior year to ensure that all property rates in the consolidated and separate financial statements was recorded in terms of *GRAP 23, Revenue from non-exchange transactions*. The municipality did not have a process to identify the valuation of properties on which property rates should be billed. As a result, property rates as disclosed in note 25 to the consolidated and separate financial statements and statement of financial performance was understated by an amount of R5,9 million. This also has an impact on the surplus for the year and on the accumulated surplus.

## **Context for the opinion**

10. I conducted my audit in accordance with the International Standards on Auditing (ISAs). My responsibilities under those standards are further described in the auditor-general's responsibilities for the audit of the consolidated and separate financial statements section of this auditor's report.
11. I am independent of the municipality in accordance with sections 290 and 291 of the International Ethics Standards Board for Accountants' *Code of ethics for professional accountants* and, parts 1 and 3 of the International Ethics Standards Board for Accountants' *International Code of Ethics for Professional Accountants (including International Independence Standards)* (IESBA codes) as well as the ethical requirements that are relevant to my audit in South Africa. I have fulfilled my other ethical responsibilities in accordance with these requirements and the IESBA codes.
12. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my qualified opinion.

## **Emphasis of matter**

13. I draw attention to the matters below. My opinion is not modified in respect of these matters.

### **Restatement of corresponding figures**

14. As disclosed in note 52 to the consolidated and separate financial statements, the corresponding figures for 30 June 2019 were restated as a result of an error in the consolidated and separate financial statements of the municipality at, and for the year ended, 30 June 2019.

### **Unauthorised expenditure**

15. As disclosed in note 47 to the consolidated and separate financial statements, unauthorised expenditure to the amount of R126,3 million that was incurred in the previous years was still under investigation.

### **Fruitless and wasteful expenditure**

16. As disclosed in note 48 to the consolidated and separate financial statements, fruitless and wasteful expenditure to the amount of R25,5 million that was incurred in the previous years was still under investigation.

### **Material underspending of the conditional grant**

17. As disclosed in note 17 to the consolidated and separate financial statements, the municipality underspent its expanded public works programme grant by R1,3 million.

## **Other matters**

18. I draw attention to the matters below. My opinion is not modified in respect of these matters.

### **Unaudited disclosure note**

19. In terms of section 125(2)(e) of the MFMA the municipality is required to disclose particulars of non-compliance with this legislation. This disclosure requirement did not form part of the audit

of the consolidated and separate financial statements and accordingly we do not express an opinion thereon.

#### **Unaudited supplementary information**

20. The supplementary information set out on pages ... to ... does not form part of the consolidated and separate financial statements and is presented as additional information. I have not audited these schedules and accordingly I do not express an opinion thereon.

#### **Responsibilities of the accounting officer for the consolidated and separate financial statements**

21. The accounting officer is responsible for the preparation and fair presentation of the consolidated and separate financial statements in accordance with the GRAP and requirements of the MFMA and Dora and for such internal control as the accounting officer determines is necessary to enable the preparation of consolidated and separate financial statements that are free from material misstatement, whether due to fraud or error.
22. In preparing the consolidated and separate financial statements, the accounting officer is responsible for assessing the municipality's ability to continue as a going concern, disclosing, as applicable, matters relating to going concern and using the going concern basis of accounting unless the appropriate governance structure either intends to liquidate the municipality or to cease operations, or has no realistic alternative but to do so.

#### **Auditor-general's responsibilities for the audit of the consolidated and separate financial statements**

23. My objectives are to obtain reasonable assurance about whether the consolidated and separate financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes my opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with the ISAs will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these consolidated and separate financial statements.
24. A further description of my responsibilities for the audit of the consolidated and separate financial statements is included in the annexure to this auditor's report.

#### **Report on the audit of the annual performance report**

##### **Introduction and scope**

25. In accordance with the Public Audit Act of South Africa, 2004 (Act No. 25 of 2004) (PAA) and the general notice issued in terms thereof, I have a responsibility to report material findings on the reported performance information against predetermined objectives for selected development priorities presented in the annual performance report. I performed procedures to identify findings but not to gather evidence to express assurance.

26. My procedures address the reported performance information, which must be based on the approved performance planning documents of the municipality. I have not evaluated the completeness and appropriateness of the performance indicators/ measures included in the planning documents. My procedures also did not extend to any disclosures or assertions relating to planned performance strategies and information in respect of future periods that may be included as part of the reported performance information. Accordingly, my findings do not extend to these matters.
27. I evaluated the usefulness and reliability of the reported performance information in accordance with the criteria developed from the performance management and reporting framework, as defined in the general notice, for the following selected development priorities presented in the annual performance report of the municipality for the year ended 30 June 2019:

<b>Development priorities</b>	<b>Pages in the annual performance report</b>
KPA 2 – Basic service delivery	X – X

28. I performed procedures to determine whether the reported performance information was properly presented and whether performance was consistent with the approved performance planning documents. I performed further procedures to determine whether the indicators and related targets were measurable and relevant, and assessed the reliability of the reported performance information to determine whether it was valid, accurate and complete.
29. The material findings in respect of the usefulness and reliability of the selected development priorities are as follows:

## **KPA 2: Basic service and Infrastructure**

### **Usefulness**

#### **Various indicators**

30. When the indicators listed below were planned, it was not determined how the achievement will be measured and monitored as source information and evidence and method of calculation of achievements was not predetermined, as required by the National Treasury's Framework for Managing Programme Performance Information (FMPPI).

<b>Performance indicator</b>	<b>Target as per Annual Performance Report</b>
% progress of 6km Constructed for Mkhuzaza gravel Access Road in ward 17	65% completed on 6 km construction of Mkhuzaza gravel access road
% progress on 5.5km Constructed for Ntlenga gravel Access Road in ward 19	65% completed on 5.5km construction of Ntlenga gravel access road

<b>Performance Indicator</b>	<b>Target as per Annual Performance Report</b>
% progress on 11km Constructed for Lumphaphansi gravel Access Road in ward 16	10% completed on 11 km construction of Lumphaphazi gravel access road
% progress on 7km Constructed for Bele gravel Access Road in ward 18	10% completed on 7 km construction of Bele gravel access road
% progress on 9km Constructed for Magoba/Dedeni gravel Access Road in ward 10	10% completed on 9 km construction of Magoba /Dedeni gravel access road
% progress on 7km Constructed for Hotana gravel Access Road in ward 8.	65%completed on 6 km construction for Hotana gravel access road
% of work done on implementation of Mfadalenzi/Mahlathi 106 Electrification in ward 3.	100 % scope of work for 106 households connections completed
% of Work done on implementation on Mpotsotsho 140 Electrification in ward 1.	55 % scope of work for 140 households connections completed
% of work done on implementation of Nonyevu/Zwelitsha 180 Electrification in ward 6.	55 % scope of work for 180 households connections completed
% of work done on implementation of Tuweni/Maplotini 106 Electrification in ward 4/5.	55% scope of work for 106 households connections completed
% of work done on implementation of Luijazo 108 Electrification in ward 11.	55 % scope of work for 108 households connections completed
% of work done on implementation of Buchele 140 Electrification in ward 11.	55 % scope of work for 140 households connections completed
% of work done on implementation of Jambeni 313 Electrification in ward 19.	65% scope of work for 313 households connections completed
% of work done on implementation of Majola 106 Electrification in ward 8.	65 % scope of work for 106 households connections completed
% of work done on implementation on of Nomvalo 98 Electrification in ward 12	65% scope of work for 98 households connections completed
No. of households benefiting from the provision of free basic service	9124
% of progress on 7 Km Constructed for Aggate Terrace paved Road	80% completed on construction of agate terrace (paved road)
% progress on 7km Constructed for Marine Drive Road	80% completed on construction of marine drive (paved road)

31. The reported targets were not consistent when compared to the planned targets.

<b>Performance indicator</b>	<b>Target as per Service Deliver and Budget Implementation Plan</b>	<b>Target as per Annual Performance Report</b>
No. of households benefiting from the provision of free basic service	9124	<u>Reported Target</u>  9124  <u>Reported Actual Performance</u>  Achieved, 38711 (Electricity provided to 34711 beneficiaries. Alternate energy provided to 4000 beneficiaries)
% progress on 7km Constructed for Marine Drive Road	80% completed on construction of agate terrace (paved road)	80% completed on construction of marine drive (paved road)

### **Reliability**

#### Various indicators

32. The municipality did not have an adequate record keeping system to enable reliable reporting on achievement of the indicators listed below. As a result, I was unable to obtain sufficient appropriate audit evidence in some instances, while in other cases the supporting evidence provided did not agree to the reported achievements. Based on the supporting evidence that was provided, the achievement of these indicators was different to the reported achievement in the annual performance report. I was also unable to further confirm the reported achievements by alternative means. Consequently, I was unable to determine whether any further adjustments were required to the reported achievements of the indicators listed below.

<b>Performance indicator/measure</b>	<b>Planned target</b>	<b>Reported achievement</b>
% progress of 6km Constructed for Mkhuzaza gravel Access Road in ward 17	65% completed on 6 km construction of Mkhuzaza gravel access road	Achieved, 65% completed on 6 km construction of Mkhuzaza gravel access road
% progress on 5.5km Constructed for Ntlenga gravel Access Road in ward 19	65% completed on 5.5km construction of Ntlenga gravel access road	Achieved, 71% completed on 5.5km construction of Ntlenga gravel access road

% progress on 7km Constructed for Hotana gravel Access Road in ward 8.	65% completed on 6 km construction for Hotana gravel access road	Achived, 90% completed on 6 km construction for Hotana gravel access road
No. of km maintained in wards	140km of roads Maintained	Achieved, 140km of roads Maintained
No. of maintained streetlights	100 street -light maintained	Achived, 100 street -light maintained
No. of km road single strand lines marked	15 km road single strand marked	Achieved, 25 km road single strand marked
No. of awareness Campaign inducted on beach safety	4 awareness campaigns conducted on Beach safety	Achieved, 4 awareness campaigns conducted on Beach safety
% of progress on 7 Km Constructed for Aggate Terrace paved Road	80% completed on construction of agate terrace (paved road)	No Achieved, 58.2% completed on construction of agate terrace (paved road)

## Other matters

33. I draw attention to the matters below.

### Achievement of planned targets

34. Refer to the annual performance report on pages ... to ... for information on the achievement of planned targets for the year. This information should be considered in the context of the material findings on the usefulness and reliability of the reported performance information in paragraphs 30 to 32 of this report.

### Unaudited supplementary schedules

35. The supplementary information set out on pages ... to ... does not form part of the annual performance report and is presented as additional information. I have not audited these schedules and, accordingly, I do not report thereon.

## Report on the audit of compliance with legislation

### Introduction and scope

36. In accordance with the PAA and the general notice issued in terms thereof, I have a responsibility to report material findings on the compliance of the municipality with specific matters in key legislation. I performed procedures to identify findings but not to gather evidence to express assurance.

37. The material findings on compliance with specific matters in key legislations are as follows:

## **Annual financial statements, performance and annual reports**

38. The financial statements submitted for auditing were not prepared in all material respects in accordance with the requirements of section 122(1) of the MFMA. Material misstatements of provisions and disclosure items identified by the auditors in the submitted financial statements were subsequently corrected and the supporting records were provided subsequently, but the uncorrected material misstatements and supporting records that could not be provided resulted in the financial statements receiving a qualified audit opinion.

## **Consequence management**

39. Some of the unauthorised expenditure incurred by the municipality was not investigated to determine if any person is liable for the expenditure, as required by section 32(2)(a) of the MFMA.
40. Some of the irregular expenditure incurred by the municipality were not investigated to determine if any person is liable for the expenditure, as required by section 32(2)(b) of the MFMA.
41. Some of the fruitless and wasteful expenditure incurred by the municipality was not investigated to determine if any person is liable for the expenditure, as required by section 32(2)(b) of the MFMA.

## **Procurement and contract management**

42. The preference point system was not applied to some of the procurement of goods and services above R30 000 as required by section 2(a) of the Preferential Procurement Policy Framework Act.
43. Some of the contracts and quotations were awarded to bidders that did not score the highest points in the evaluation process, as required by section 2(1)(f) of Preferential Procurement Policy Framework Act and Preferential Procurement Regulations.

## **Strategic planning and performance management**

44. The performance management system and related controls were inadequate as it did not describe how the performance planning, monitoring, measurement, review, reporting and improvement processes should be conducted, organised and managed, as required by municipal planning and performance management regulation 7(1).
45. The annual performance objectives and indicators were not established by agreement with the parent municipality, as required by section 93B(a) of the MSA.

## **Expenditure management**

46. Reasonable steps were not taken to prevent irregular expenditure, as required by section 62(1)(d) of the MFMA. The expenditure disclosed does not reflect the full extent of the irregular expenditure incurred as indicated in the basis for qualification paragraph. The majority of the irregular expenditure was caused by awards made in contravention of the SCM regulations, regulation 32 incorrectly applied and three written quotations not obtained.

47. Reasonable steps were not taken to prevent fruitless and wasteful expenditure amounting to R1,5 million, as disclosed in note 48 to the consolidated and separate annual financial statements, in contravention of section 62(1)(d) of the MFMA. The majority of the disclosed fruitless and wasteful expenditure was caused by penalties to SARS and payments made for inventory not delivered.
48. Reasonable steps were not taken to prevent unauthorised expenditure amounting to R3,9 million, as disclosed in note 47 to the annual financial statements, in contravention of section 62(1)(d) of the MFMA. The majority of the unauthorised expenditure was caused by over spending for community services.
49. Money owed by the municipality was not always paid within 30 days, as required by section 65(2)(e) of the MFMA.

### **Reckless Trading**

50. The entity had conducted its business recklessly in the current financial year as it had deregistered the non-profit company (NPC) effective 30 November 2016 without following appropriate and adequate procedural requirements. The entity furthermore carried on trading subsequent to deregistration while also being insolvent and illiquid.

### **Other information**

51. The accounting officer is responsible for the other information. The other information comprises the information included in the annual report which includes the audit committee's report. The other information does not include the financial statements, the auditor's report and those selected development priorities presented in the annual performance report that have been specifically reported in this auditor's report.
52. My opinion on the consolidated and separate financial statements and findings on the reported performance information and compliance with legislation do not cover the other information and I do not express an audit opinion or any form of assurance conclusion thereon.
53. In connection with my audit, my responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the consolidated and separate financial statements and the selected development priorities presented in the annual performance report, or my knowledge obtained in the audit, or otherwise appears to be materially misstated.
54. I did not receive the other information prior to the date of this auditor's report. When I do receive and read this information, if I conclude that there is a material misstatement therein, I am required to communicate the matter to those charged with governance and request that the other information be corrected. If the other information is not corrected, I may have to retract this auditor's report and re-issue an amended report as appropriate. However, if it is corrected this will not be necessary.

## **Internal control deficiencies**

55. I considered internal control relevant to my audit of the consolidated and separate financial statements, reported performance information and compliance with applicable legislation; however, my objective was not to express any form of assurance on it. The matters reported below are limited to the significant internal control deficiencies that resulted in the basis for the qualified opinion, the findings on the annual performance report and the findings on compliance with legislation included in this report.
- Slow response by leadership on addressing external audit findings from previous years has resulted in repeat findings and stagnation in audit outcomes. Undue delays in filling key positions has impacted the improvement process in the internal control environment. Holding officials accountable and consequence management remains areas of concern. There is also inadequate oversight and monitoring of performance reporting and compliance with legislation.
  - Effective financial systems of internal controls and the management thereof had not been implemented throughout the financial year to ensure accurate financial statements. The preparation and review of the financial statements is not adequately planned to ensure a comprehensive review of year-end adjustments and reconciliation, resulting in errors.
  - The quality of annual performance report was poor as significant audit findings were identified in usefulness and/or reliability of performance indicators and targets. This is as a result of the municipality not having a policy on performance information and clarifying standard operating procedures on performance reporting. Furthermore, there is a lack of understanding by management of National Treasury Framework for Managing Programme Performance Information (FMPPI) and poor record keeping to support performance reporting.

## Other reports

56. I draw attention to the following engagements conducted by various parties that have or could potentially have an impact on the municipality's financial statements, reported performance information and compliance with applicable legislation and other related matters. The reports noted do not form part of the opinion on the financial statements or findings on the reported performance information or compliance with legislation.

## Investigations

57. There is an independent investigation on irregular expenditure, fruitless and wasteful expenditure and unauthorised expenditure incurred in the previous years being performed jointly by the Department of Cooperative Governance and Traditional Affairs and National Treasury. These investigations are still underway, and their reports will inform the municipality on how to deal with the expenditure as directed by legislation.

Auditor General

East London

06 December 2019



AUDITOR-GENERAL  
SOUTH AFRICA

*Auditing to build public confidence*